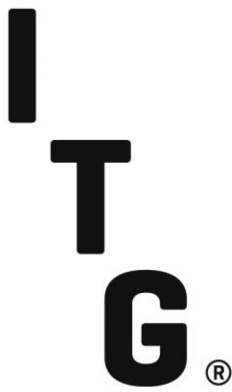

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Members of the Canadian Securities Administrators

ITG Canada (ITG) would like to thank the Ontario Securities Commission (OSC) for this opportunity to comment on the proposed changes to the Order Protection Rules (OPR). A few years ago the OSC appropriately responded to changing market dynamics, including RegNMS and Maker Taker models in the US, and later the advent of competing marketplaces in Canada. We applaud the OSC for recognizing that there have been further developments, including some negative unintended consequences, that need to be addressed to maintain the integrity of Canada's Capital Markets regime.

ITG's thoughts on this proposal, and all market structure matters, are largely influenced by our aim to provide benefits to our natural customers in order to further foster healthy competitive markets and a positive, dynamic market structure.

In a similar vein to the OSC, ITG firmly believes that markets should be fair, competitive, transparent and practical in order to attract the greatest possible participation of natural investors. These are some of the hallmarks of robust Capital Markets.

In terms of fairness, and competitiveness, we believe that regulators should take adequate steps to ensure a level playing field for beneficial competition within groups of investors, dealers and marketplaces. Should the systems, either through regulation or excessive barriers, prevent or degrade such competition, we risk a market that may lack the confidence of both providers and consumers of capital, to achieve their full potential. The end result could be a weakened Canadian Capital Markets, thus putting us at a disadvantage when competing for issuers and investors who have more options globally.

With that in mind, we will be concentrating our thoughts on the following issues:

1) The proposal of a market place threshold to earn protected status
2) The capping of marketplace trading fees

3) Market data fees
4) Locked and crossed markets
5) A pilot study on marketplace rebate pricing mechanisms
6) Marketplace liability

Marketplace Thresholds

ITG has been negatively impacted by the increased connectivity costs of marketplaces, especially for marketplaces that seem duplicative without adding true innovation or added value. As such, it would make sense for there to be some mechanism by which new entrants would not be able to force connectivity and market data fees on dealers already struggling to contain costs in a decidedly tough environment. So, while ITG appreciates the desire to set a threshold level, to curtail the cost of new markets that offer little or no value to the dealer community, we believe that a threshold style approach may result in an environment where new markets are challenged to attract passive flow from natural investors, and perversely incented to cater to proprietary intermediaries. We understand this is not the intent of the OSC, but this is a critical consideration.

To illuminate this argument, we need to first consider how IIROC plans on looking at client priority. On May 15th, 2014, IIROC published a companion proposal to the OSC OPR proposals, highlighting the changes to UMIR that would accompany changes to OPR. Section 5.3 – the client priority section – states that IIROC would make the presumption "**an order at a specific price may execute on a protected marketplace before an order on an unprotected marketplace since not all Participants may have information on orders on the unprotected marketplace or access to trade on that marketplace**". Notwithstanding that icebergs and flickering quotes on lit (protected) marketplaces are equally obscure to investors, there appears to be a bias against unprotected markets. We read this as a regulatory interpretation that protected markets will be deemed superior to non protected markets. Sometimes, some non protected markets may provide protection from gaming and added block liquidity and thus be the best place to post a given order, or part of a given order. The compliance burden worn by any dealer placing agency flow onto an unprotected market will create an almost insurmountable barrier to entry for new marketplaces. The only firms not subject to this interpretation are those trading strictly proprietary flow. As such, new marketplaces will have the greatest

opportunity for success if they pursue passive orders from proprietary traders, rather than create a venue that is friendly to other resting agency orders from natural investors. This completely devastates the opportunity for new markets to focus on garnering and serving natural trade flow, and could lead to a state of either no new markets, or – even worse - new markets with a bias for proprietary flow. This seems completely at odds with the drivers behind the CSA's proposed rule changes. It is important to remember that protected status is based on a venues overall market share. As such, they may have far greater market share in a given name, or class of products (e.g. ETFs, preferreds) but still not be a suitable venue for posting client orders in those instruments. This would result in proprietary participants having advantaged access to liquidity in these names.

At the end of the day, imposing a threshold of any level could create a bifurcated market where some venues are deemed superior to others, regardless of actual features, costs, single name liquidity, service or fill rates. While this threshold will undoubtedly prevent existing markets from creating costly second, or third books that add little or no new innovation, it would also create a significant real barrier to innovative offerings and healthy competition aimed at improving the trading landscape for natural investors.

This inevitably leads to the question of how we prevent new markets that prejudiciously fragment but don't truly compete, without stifling true innovation. We believe there are other options, and here we highlight two other potential proposals available to regulators.

1) Keep OPR as is, but speed up the maker / taker study. If the regulators ban rebate driven marketplace pricing models, the markets will not be incented to roll out new markets underpinned almost exclusively by some variation of such pricing; in fact this may slim down the duplicative models in existence solely based on such pricing incentive programs. The potential downfall to this is a loss of flow on interlisted names where passive orders appear to be more attractive in the US due to the subsidy such models offer for posting liquidity. Since the Canadian Capital Markets can ill afford to lose significant market share in interlisted names, and any solution that doesn't include interlisted names still leaves sufficient incentive for new fragmenting markets to open. So this concept would work best if coordinated with our southern neighbours.

2) Get rid of Order Protection all together. Let the invisible hand – guided strongly by informed buy side traders and portfolio managers – ensure that sell side firms access viable liquidity and achieve some form of best execution. Deem all markets to be equal in the eyes of the regulators, and let the data informed dealers and clients determine how best to capture liquidity. And define the CBBO as the best visible bid and offer. Dark pools do not have to access a venue to consider its quote for mid-point pricing, so have them consider all such quotes. This solution will discourage start up markets that do not provide true value to participants who will then have the ability to ignore them. At the same time, real innovators will have the opportunity to compete for flow from all types of client – eliminating the need for them to cater to propeitary-focused participants. . Best execution obligations will still prevent dealers from placing passive orders on venues that offer subpar opportunity for fills, and to consider all meaningful markets.

   Underpinning the elimination of OPR would be a requirement for participants to provide full disclosure and measurement should they choose not to connect to a marketplace.

   Some members of the CSA have argued that the lack of an Order Protection Rule is unmanageable, and will result in them having to strictly define best execution. We disagree with this notion, and believe that commercial forces, along with fair access rules and appropriate transparency around dealer's usage of various venues, will give clients the information needed to make informed decisions to select which dealers will offer them true best execution, Further, the continued existence of the best execution rule still requires traders, on both the sell and buy side, to act in the best interest of the end client. If the Best Execution rules aren't sufficient to ensure brokers behave in an appropriate manner, one must questions why they exist. Finally we would respectfully argue that the problem around regulators managing dealer behavior is only lessened under the proposed model if unprotected markets are deemed, either formally or informally, to be inferior to protected markets. Deeming unprotected markets to be on equal footing as protected markets is identical to outright ending OPR from a regulatory oversight perspective.

The Capping of Marketplace Trading Fees

ITG applauds the initiative to cap trading fees by marketplaces. Fees charged by Canadian venues can currently exceed the U.S. cap by as much as 16%, despite Canada having a significantly lower average stock price than the U.S. market. This might be part of the reason why Canada loses some flow on interlisted names to the US. These artificially inflated active fees facilitate higher passive rebates, which then create motive for undue intermediation of already liquid issues. However, given the significantly lower price of Canadian stocks and the continued chatter around the U.S. moving to lower marketplace fees, we respectfully suggest that 30 mills is too high, even as a starting point. While we normally argue that the forces of free markets will force price compression, this clearly has not been the case in this instance. Of late, we have heard much consternation, from the TMX, and others, that retail interlisted flows are being exported to the U.S. market, without any visible sign of a commercial response from the dominant marketplace. This suggests that the time has come to lower the price in Canada of such fees.

Market Data Fees

ITG has long believed that Canadian real time market data fees are out of line with other developed International markets. We strongly back the notion of a study to analyze fees of other MSCI Developed Market nations, normalized by both volume and value traded, and set Canadian fees at a level far closer to the median or mean. The friction imposed upon our market by such fees can only be detrimental to our ability to attract global investors towards our marketplace. We appreciate that regulators typically do not relish the role of price setter, and applaud the CSA for their willingness to make an exception to better align Canadian fees with the international markets against whom we compete daily.

We have plenty of thoughts on the potential metrics that might be used to determine fair price of data, and some of the metrics to avoid, in order to ensure we don't promote strategies like tape shredding that closely followed the U.S. markets data fee regulation. Rather than compose a document on this, we would prefer to present our thoughts directly to the regulator in person to allow for a two way discussion on this matter.

Locked and Crossed Markets

One of the greatest concerns of any change to the Order Protection Rules is the return of locked market arbitrage to Canada. Canada allowed locked markets for a couple of years after the arrival of the first wave of lit ATS'. Sadly the tick data from that time period is not readily available to study, but we believe that the intentional locking of markets was a negative behavior, used almost exclusively for inventory reduction trades as part of a rebate arbitrage strategy. Such strategy might needlessly increase very short term intermediation in already liquid issues, offering up trading profits for near zero risk. As such, we strongly suggest that any threshold to, or disbanding of the Order Protection Rules contain a caveat that prevents traders from intentionally locking or crossing a market on which they routinely trade. As such, if a trader has access to marketplace X, they would not be allowed to lock purposefully said markets quote. Traders would only be able to lock, or cross the quote of a market they can't access.

Pilot Study on Marketplace Rebate Fee Structures

When one thinks about the dealer routing conflicts of interest routinely cited as a problem, the vast majority of these issues result from marketplace rebate fee structures. As such, we believe that markets would be well off to abandon such fee mechanisms. While the quoted spread MAY widen slightly – not a certainty by any means – we don't believe the effective spread will widen. To be clear, while the spread on highly liquid and low priced securities might be further tightened by proprietary traders who are in and out of positions within minutes, trading for a rebate arbitrage, this does not necessarily help natural investors looking to enter or exit positions. But the key is to gather the data. For this reason we would be supportive of a pilot study that banned such structures.

As an ancillary benefit, we believe that forcing markets to compete on something besides liquidity subsidies would likely result in markets becoming more innovative and focused on natural investors in their offerings. It is very reasonable to expect that such a ban would result in consolidation of the lit markets in Canada, and remove much of the unnecessary complexity which

confuses retail participants and frustrates institutional investors. The likely result would be fewer marketplaces with differentiated product offerings.

Having stated our support for such a pilot, we are very sympathetic of the arguments put forth by Jeffrey C. Sprecher, CEO of ICE, in the U.S. market. Mr. Sprecher has clearly stated a desire to remove maker / taker style pricing from the NYSE but believes that doing so while other U.S. markets continue to offer rebates would be economic suicide. This is equally true of Canada removing rebate models from interlisted names while the U.S. market continues to offer up such subsidies. We cannot, as a country, afford to leak liquidity on Canadian issues to the U.S. market without risking the ultimate robustness of our Capital markets. As such, we recommend the pilot be restricted to non interlisted companies unless Canadian regulators are somehow able to convince U.S.regulators to do a similar study in tandem.

Such a pilot will require great thought to ensure the academic study on impact to market quality appreciates not just the quoted spread, but also the effective spread and total market impact costs. As the global leader in trading cost measurement we again offer up our continued consultation around the construction of such analytics.

Marketplace liability

Currently the captive consumer imbalance allows for marketplaces to include strict indemnity clauses in their dealer contracts grossly limiting their liability in the event of an outage, error or failure. While a threshold or disbanding of OPR will remove the captive consumer imbalance, and allow dealers to renegotiate such contracts with smaller markets, larger markets will still enjoy the benefits of captive consumers, and are unlikely to accept such liability unless the regulators so require. It would seem in keeping with the spirit of fair access to not let 100% of the liability for exchange errors to rest with participants. . The current unbalanced liability structure is particularly frustrating for dealers, as the marketplaces make technology decisions largely designed to reduce latency, with little input from the dealer community. The TMX migration to the Quantum XA trading engine is a particularly good example of a marketplace undertaking a

technology decision that was designed almost exclusively for the benefit of short term intermediaries, resulting in great cost, distraction and risk to the dealer

community. Were the TMX to wear the increased risk associated with a 95% reduction in order acknowledgment latencies we believe the architecture and roll out of the engine would have been done in a manner that was more considerate of the risk and cost.

To date the only argument put forth by the marketplace community against assuming liability is that regulators have imposed standards on their technology process. This argument fails when you consider that the same was true of Nasdaq pre the Facebook IPO issue and Knight Capital before its August 1 2012 trading error. The marketplaces need to have skin in the game to ensure they behave in a manner that is respectful of the risk they are introducing to all players within the market. We will be most disappointed if the regulators do not address this long standing issue.

Conclusion

In sum, we are grateful for the opportunity the OSC has provided to reexamine OPR, and giving ITG the chance to provide commentary on these critical and wide-ranging but connected issues. We applaud this review of OPR in order to attempt to rectify some of the negative unintended consiequences that now permeate the Canadian markets.. We strongly support caps on trading and real time data fees that allow for markets to achieve a fair profit, but also provide proper incentives for innovation, service and efficiency. We also support a pilot study on rebate driven fee models for non interlisted names, and the implementation of marketplace liability. The one area of the proposal we do not heavily support is the threshold for protected status. We believe the threshold may add complexity without resulting in an optimal market structure environment, and might create a barrier to entry that protects the incumbents, and ultimately, albeit unintentionally, will harm true competition in the equity matching sphere.

ITG is committed to aiding the regulators throughout this process, and always welcome the opportunity to discuss these matters in person, or answer any questions. . We would appreciate the opportunity to participate in any roundtables, or hearings on these changes.

Sincerely

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